

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeem G. Kelly.

International Transmission Company

Docket No. AC03-33-000

ORDER ADDRESSING ACCOUNTING FOR DIVESTITURE TRANSACTIONS
AND RATEMAKING ITEMS

(Issued April 29, 2004)

1. On March 24, 2003 International Transmission Company (International Transmission) submitted a compliance filing in response to the Commission's order issued on February 20, 2003 (February 20 Order).¹ As relevant here, the February 20 Order required International Transmission to submit its accounting for certain divestiture transactions and ratemaking items to the Commission for review.

2. In this order, we accept in part and modify in part International Transmission's accounting for the divestiture transactions and ratemaking items and direct it to make certain conforming changes to its tariff to properly reflect the accounting approved herein. This order benefits customers by ensuring that items included in International Transmission's formula transmission rates are properly accounted for under the Commission's Uniform System of Accounts (USofA) and related accounting rules.

Background

3. On December 24, 2002, ITC Holdings Corporation (ITC Holdings), ITC Holdings Limited Partnership (ITC Holdings LP), International Transmission Company, DTE Energy, and Detroit Edison, filed a joint application pursuant to section 203 of the Federal Power Act (FPA)² for Commission authorization for the disposition of International Transmission's jurisdictional facilities to ITC Holdings through the sale of International Transmission's stock to ITC Holdings, an independent and unaffiliated purchaser. The jurisdictional assets involved include all physical transmission facilities

¹ ITC Holdings Corp., et al., 102 FERC ¶ 61,182 (2003).

² 16 U.S.C. § 824b (2000).

owned by International Transmission, as well as all contracts, related books, and records. The applicants also submitted for filing proposed transmission rates for International Transmission, pursuant to section 205 of the FPA,³ to become effective upon closing of the proposed disposition, without modification, suspension, or hearing, and certain operating and interconnection agreements between International Transmission and Detroit Edison.

4. In the February 20 Order, the Commission authorized the disposition of the jurisdictional facilities, accepted in part and rejected in part International Transmission's proposed transmission rates, accepted for filing certain operating and interconnection agreements between International Transmission and Detroit Edison Company, and directed International Transmission to make certain compliance filings, including the submission of its proposed accounting for the divestiture transactions and ratemaking items.

5. On March 24, 2003, International Transmission submitted a filing to comply with the February 20 Order. As part of its compliance filing, International Transmission submitted its proposed accounting for the divestiture transactions and certain ratemaking items.

6. By order issued on July 2, 2003, the Commission denied requests for rehearing of its February 20 Order, accepted International Transmission's compliance filing but deferred action on International Transmission's proposed accounting.⁴ In the July 2 Order, the Commission indicated that International Transmission's proposed accounting would be addressed in a separate order. This order addresses International Transmission's accounting for the divestiture transactions and related ratemaking items.

Discussion

7. In general, International Transmission's proposed accounting for the divestiture transaction, including the ratemaking items noted in the February 20 Order, follows the purchase method of accounting consistent with generally accepted accounting principles.⁵

³ 16 U.S.C. § 824d (2000).

⁴ ITC Holdings Corp., *et al.*, 104 FERC ¶ 61,033 (2003) (July 2 Order).

⁵ Under this method, International Transmission allocated the purchase price to the identifiable assets acquired and liabilities assumed (except for the portion of the purchase price for which ITC did not seek rate recovery and therefore recorded as goodwill on the accounts of ITC Holdings, the parent company of International Transmission).

The Commission has approved the use of the purchase method of accounting in other cases involving the disposition and acquisition of facilities.⁶ Therefore, the Commission accepts International Transmission's proposed accounting for the divestiture transaction and ratemaking items included in its March 24 filing, subject to the modifications discussed below.

Adjustment for Accumulated Deferred Income Taxes (ADIT)

8. The purchase price that ITC Holdings paid to DTE Energy for International Transmission included an incentive amount to complete the transaction that was equal to the balance of ADIT on International Transmission's books at closing estimated to be \$59 million (ADIT Adjustment).

9. In the February 20 Order, the Commission approved International Transmission's request to defer and recover the ADIT Adjustment in rates, based on the significant benefits that a for-profit, stand-alone transmission business provides in remedying undue discrimination in the provision of transmission service.

10. In its March 24 filing, International Transmission proposed to account for the ADIT Adjustment as a regulatory asset in Account 182.3, Other Regulatory Assets. However, the amount characterized as an ADIT Adjustment does not meet the definition of a regulatory asset (*i.e.*, an amount otherwise chargeable to expense in the current period).⁷ The \$59 million instead represents an amount paid by ITC Holdings in excess of the net book value of the transmission assets acquired from DTE Energy.

11. Under the USofA, amounts paid above the existing net book value of acquired utility plant are considered acquisition adjustments. Entities are required to record acquisition adjustments in Account 114, Electric Plant Acquisition Adjustments.⁸

12. We will therefore require International Transmission to modify its accounting to reflect the ADIT Adjustment as a plant acquisition adjustment in Account 114. Additionally, International Transmission is required to make all required changes to its transmission rate formula under Attachment O of the Midwest Independent Transmission

⁶ See, *e.g.*, Entergy Services Inc. and Gulf States Utilities Co., 65 FERC ¶ 61,332 (1993); El Paso Electric Co. and Central and South West Services, Inc., 68 FERC ¶ 61,181 (1994).

⁷ 18 C.F.R. Part 101, Account No. 182.3 (2003).

⁸ 18 C.F.R. Part 101, Account No. 114 (2003).

System Operator, Inc.'s (Midwest ISO) open access transmission tariff (Tariff) to reflect this accounting. The required tariff changes, however, will not alter the amount or timing of billings under the formula rate. These tariff changes are needed to insure that the revised account classification results in the same billing that would have occurred under the proposed account classification.

Deferred Recovery of Costs under Attachment O

13. International Transmission transferred functional control of its transmission facilities to the Midwest ISO. As a result, International Transmission's rate for transmission service, in the International Transmission pricing zone, is determined using the formula included in Attachment O under the Midwest ISO Tariff. Under the Attachment O rate formula, rates are updated effective June 1 of each year, based on FERC Form No. 1 data for the previous calendar year.

14. As part of the disposition of facilities in this proceeding, International Transmission agreed to freeze its zonal rate at \$1.075/kW-month from the closing date of the sale through December 31, 2004. In addition, International Transmission proposed and the Commission approved in its February 20 Order a deferral mechanism during the rate freeze. Under the deferral mechanism, International Transmission is allowed to defer the difference between what the Attachment O formula would otherwise yield for the given calendar year based on current costs of operation and the frozen rate of \$1.075/kW-month. International Transmission is then allowed to recover this deferral amount in its rates over a five-year period beginning June 1, 2006.

15. International Transmission proposes to record the regulatory asset related to the Attachment O deferral by debiting Account 182.3 and crediting Account 421, Miscellaneous Nonoperating Income. The instructions to Account 182.3⁹ of the USofA, however, require that regulatory assets be established through credits to Account 407.4, Regulatory Credits, rather than Account 421. We will therefore require International Transmission to modify its accounting to use Account 407.4 in establishing this regulatory asset.

16. In its March 24 compliance filing, International Transmission also proposed to amortize the Attachment O deferral for a five-year period beginning January 1, 2005, even though it would not be collecting any of the deferred amounts in rates until June 1, 2006. This causes a 17-month mismatch between the time that International

⁹ See Paragraph B to the instructions of Account 182.3. 18 C.F.R. Part 101, Account No. 182.3 (2003)).

Transmission proposes to expense these deferred costs for financial statement purposes and the time they are included in rates and collected from customers.

17. Including an expense in a different accounting period from the revenues designed and approved to provide for its recovery may result in misleading financial statements, as the results of operations may not be fairly portrayed. Consequently, under our accounting rules an entity is required to concurrently charge expense with the recovery of amounts in rates.¹⁰ We will therefore require International Transmission to start amortization of the Attachment O deferral starting on June 1, 2006, the same time it begins collecting these deferred costs in rates, rather than January 1, 2005. Additionally, International Transmission is required to make all required changes to its transmission rate formula to reflect this accounting. Again, the required tariff changes will not alter the amount or timing of billings under the previously approved formula rate. These tariff changes are needed to insure that the revised accounting amortization results in the same billing that would have otherwise occurred.

Equity Ownership Interest

18. International Transmission proposed to account for the equity transactions for the purchase of assets in Account 207, Premium on Capital Stock. However, investors' capital of this nature is required to be recorded in Account 201, Common Stock Issued, under the USofA.¹¹ We will, therefore, require International Transmission to revise its accounting to record the investors' capital related to this transaction in Account 201.

The Commission orders:

(A) Applicant's proposed accounting is hereby accepted in part and modified in part, as discussed in the body of this order.

(B) Applicant is hereby directed to file, within 30 days of the issuance of this order, a compliance filing to revise its tariff, as discussed in the body of this order.

By the Commission.

(S E A L)

Linda Mitry,
Acting Secretary.

¹⁰ Id.

¹¹ 18 C.F.R. Part 101, Account No. 201 (2003).